IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1948.

Nos. ~~834 - 835~~ 94-95

ERNEST A. JACKSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HARRIS TRUST AND SAVINGS BANK, AS EXECUTOR (ESTATE OF ROBERT O. FARRELL, DECEASED),
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CARROLL J. LORD,
Attorney for Ernest A. Jackson, One of the Above Named Petitioners.

LELAND K. NEEVES,
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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your Petitioners respectfully pray for writs of certiorari to review two judgments of the United States Court of Appeals for the Seventh Circuit which affirmed judgments of the Tax Court of the United States confirming deficiencies against Petitioners for income taxes for the calendar year 1941 in the amounts of $36,870.26 and $71,620.14, respectively. Because of the identity of issue in the two cases, Petitioners join in this petition.

OPINIONS BELOW.

The opinion of the Tax Court was promulgated on September 10, 1947. It is reported in 9 T. C. 307, and appears in the record at page 57.

The opinion below is reported in 172 F. (2d) 607, and appears in the record at page 90. In both the Tax Court and the court below a single opinion was promulgated in the two cases.

The judgments of the Tax Court were rendered on September 11, 1947. (R. 62-63.)

JURISDICTION.

The judgments below were rendered on February 17, 1949. (R. 95-96.) Petitions for rehearing were denied on March 16, 1949. (R. 97-98.)

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1254 (1).

QUESTIONS PRESENTED.

1. Whether the court below erred in holding that Article 1561 of Regulations 69 (1926) was a correct interpretation of the Revenue Act of 1926 and that carrying charges were properly chargeable under that Act to capital account.

2. Whether the expenditures here involved, namely, rent, taxes, interest, and financing charges, are carrying charges.

STATUTES AND REGULATIONS INVOLVED.

The applicable portions of the Revenue Acts of 1924, 1926, 1928 and 1932, together with the applicable portions of Regulations 65, 69, 74, and 77 are set out in the appendix.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The two cases involve the same issue. They were consolidated in the Tax Court for hearing and decision. (R. 1, 3.) They were heard in the court below upon a consolidated record. (R. 80.)

The sole issue in the two cases is as to whether a distribution to Petitioners in 1941 made by Wabash-Monroe Building Corporation, was from "earnings or profits" and taxable as a dividend, as contended by Respondent, or was from capital, and taxable merely as capital gain, as contended by Petitioners. The determination of this issue depends upon the amount of the "earnings or profits" of the corporation in 1941, and, under the stipulations upon which the cases were tried, turns upon whether certain items of rent, taxes, interest, and financing charges which were paid by the corporation in 1926 and 1927 and charged to "capital account", were properly so charged. Respondent contends that the items were properly charged to capital account under the authority of Article 1561 of Regulations 69 (1926); that all the items here involved are carrying charges within the meaning of that Regulation; and that in any event all the items were "capital" items properly chargeable to capital account within the meaning of

Section 202(b) of the 1926 Act, wholly apart, it is said, from the Regulation.

Petitioners contend that the items in question were not expenditures or items "properly chargeable to capital account" under the provisions of said Section 202(b); that, with the bare exception of the one item of Federal income tax paid with respect to the corporation's tax free covenant bonds, they were items of expense specifically required by Section 234(a) of the Act to be deducted in computing net income; that said Article 1561 is invalid in so far as it attempts to authorize the capitalization of carrying charges for the reason that said Article in such regard is in plain contravention of the statute; and finally that the items are not carrying charges at all.

The question as to whether the items are carrying charges arises not only with respect to the Revenue Acts prior to the Revenue Act of 1932 and with respect to Regulations 65, 69, and 74, but also arises with respect to the special wording of the 1932 and subsequent Revenue Acts which in terms permit the capitalization of carrying charges.

The facts were for the most part stipulated. (R. 28, 38.) Briefly, they are as follows:

Petitioner Ernest A. Jackson and the decedent, Robert O. Farrell, who owned, respectively, 45 per cent and 50 per cent of the outstanding stock of Wabash-Monroe Building Corporation, received a cash distribution from the corporation in 1941 in the amounts of $112,500 and $125,000, respectively. In their income tax returns for 1941 they reported the distribution as a return of capital upon the ground that for income tax accounting purposes the corporation at that time had no earnings or profits. Upon audit the deficiencies here in question were asserted on the ground that the corporation had earnings and profits

sufficient to constitute the distribution a taxable dividend. (R. 8, 19.)

Wabash-Monroe Building Corporation was organized in 1925 for the purpose of acquiring a lease on certain real estate in Chicago and for the purpose of erecting and operating a building thereon. The lease was for a period of 99 years, commencing September 1, 1925. The rent from March 1, 1926 to February 28, 1927 was $75,000, and from March 1, 1927 until the termination of the lease $120,000 per annum. (R. 21.) Lessee was required to pay the real estate taxes, (R. 42-44) and to commence the construction of a new building on the premises on or about April 1, 1926, and to complete the same within fourteen months thereafter. (R. 45.) In accordance with these requirements the corporation constructed a new building on the demised premises, and completed the same on or about June 30, 1927. (R. 29.)

During the construction period the corporation had no income other than interest on the unused portion of its construction funds. (R. 29.)

The cost of the building, as first reflected upon the corporation's books, was $2,505,907.83. (R. 29-31.) Later, upon audit, the examining agent reduced the cost of the building to $2,491,187.57 as of July 1, 1927. (R. 31.) The reduction of $14,720.27 is not in controversy.

Included in the above "cost" were the following items which had been expended by the corporation during the construction period (Stip. of Facts, Pars. 7. 9; R. 32-33):

Rent and interest—	
Ground rentals under 99 year lease paid to Estate of Leon Mandel for period of March 1, 1926 to June 30, 1927	$115,000.00(a)

Interest		
Paid on bonds and notes to June 30, 1927.....	$237.203.97	
Less—Interest income received on bank deposits and escrow funds of Wabash-Monroe Building Corporation.....	87,942.38	149,261.59(b)
Taxes		
Michigan state tax on bonds	155.00	
Illinois franchise tax...	500.00	
Real estate taxes paid which were required by ground lease.....	80,376.04	
Federal income tax on tax free covenant bonds of Wabash-Monroe Building Corporation	5,227.50	86,258.54(c)
Trustee fees to banks for services in acting as disbursing agents.....	8,285.42	
Compensation paid Ward Castle for financing services	25,000.00	33,285.42(d)

The above items aggregate $383,305.55.

From July 1, 1927 to July 1, 1937, depreciation was claimed and allowed for income tax purposes on the above mentioned building cost of $2,491,187.56. For the period from January 1, 1938, to November 30, 1941, depreciation was claimed and allowed for income tax purposes based on a building cost of $2,486,774.80. (Stip. of Facts, Par. 12; R. 34.) This reduction of cost of $4,412.70 (which is explained in Par. 11 of the Stipulation, R. 34) is not here in controversy.

No adjustment of the above building cost was ever

sought by the corporation for depreciation purposes excepting that with respect to its taxable year ended November 30, 1943, the corporation, in a protest filed with the Internal Revenue Agent in Charge at Chicago, proposed to decrease the cost of the building and to calculate depreciation for that year on the amount of the decreased cost further reduced by all depreciation allowed from July 1, 1927 to November 30, 1942. (Stip. of Facts, Par. 14; R. 34, 35.)

At a meeting held on November 19, 1941, the directors of the corporation directed a distribution to the stockholders on November 30th, to be made from "capital surplus." (R. 36.) The distribution was as follows:

Robert O. Farrell.....	$125,000
Ernest A. Jackson.....	115,000
Carroll J. Lord.....	12,500

It was stipulated that the corporation had no net earnings or profits available for dividends as a result of its operations from January 1 to November 30, 1941. (Stip. of Facts, Par. 19; R. 36.)

It was further stipulated (Stip. of Facts, Pars. 21, 22; R. 37) as follows:

"21. If, under the circumstances of this proceeding, the Court holds that items (a), (b), (c), and (d) of paragraphs 7 and 9 hereof were properly charged to building costs as distinguished from a charge against earnings and profits, it is agreed that the earnings and profits accumulated after February 28, 1913 of the Wabash-Monroe Building Corporation as at January 1, 1941 was $301,090.15.

"22. If under the circumstances of this proceeding, the Court holds that items (a), (b), (c) and (d) of paragraphs 7 and 9 hereof, or any of them, constitute proper charges against earnings and profits as distinguished from a charge to building costs, it is agreed that each of such items (a), (b), (c) and (d),

would constitute a pro tanto reduction of the aforesaid amount of accumulated earnings as at January 1, 1941 of $301,090.16."

All of the expenditures in question were made in 1926 and 1927. The court is in agreement with the parties hereto that the issue herein is to be determined by the law in effect in those years—which was the Revenue Act of 1926 and any valid Regulation thereunder. The determination of the issue is in no way controlled by the special wording of the 1932 Act. The court below resorted to that Act, merely as being a Congressional approval of the 1926 Regulation (R. 93), and as showing the Congressional intention, presumably with respect to the earlier Acts. (R. 94.)

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRITS OF CERTIORARI HEREIN PRAYED.

The court below has held (1) that Article 1561 of Regulation 69, purporting to authorize the capitalization of carrying charges, was a correct interpretation of the Revenue Act of 1926, and (2) that all the expenditures made by the corporation in 1926 and 1927 for rent, interest, taxes and financing charges, amounting to $383,305.33, being the items here involved, were carrying charges.

The result is, that, in accordance with paragraphs 21 and 22 of the Stipulation of Facts heretofore referred to, the accumulated earnings of Wabash-Monroe Building Corporation, as per the books, amounting, in 1941, to $301,090.15, are not to be reduced by any of the items in question, and the corporation accordingly had "earnings or profits" in 1941 sufficient in amount to constitute the distribution then made a taxable dividend.

1. The decision of the court below is in direct conflict with the decision upon the same matter of the Court of Appeals for the Fifth Circuit in *Central Real Estate Co.* v. *Commissioner*, 47 F. (2d) 1036, which held said Article 1561 to be invalid. The court there held that the Regulation was in plain contravention of the statute, which did not permit carrying charges to be capitalized, since the statute (section 234(a) of the Revenue Act of 1926) specifically provided for the deduction of interest and taxes in determining net income. The conflict between that decision and the decision below appears from the opinion below wherein it was said (R. 93):

> "In the light of our foregoing discussion, we cannot agree that the court [the Fifth Circuit in *Central*] did not hold the regulation invalid."

And further (R. 94):

> "It is true that while the Central Real Estate decision was rendered prior to the Act of 1932, it is apparent that its conclusion in regard to regulation 69 was a misinterpretation of Congressional intention."

Prior to the decisions below, the decision in *Central* had been uniformly accepted by the courts as correctly interpretive of all the Revenue Acts prior to the Revenue Act of 1932. We refer the court to the following decisions so accepting and following the decision in *Central:*

H. M. O. Lumber Co. v. *United States,* C. A. 6, 59 F. (2d) 907.

Queensboro Corp. v. *Commissioner,* C. A. 2, 134 F. (2d) 942.

Moran v. *United States,* Ct. Cl., 19 F. Supp. 557.

Southern Railway Co. v. *Commissioner,* 27 B. T. A. 673.

Great Northern Ry. Co. v. *Commissioner,* 30 B. T. A. 691.

Kentucky Natural Gas Corp. v. *Commissioner,* 47 B. T. A. 330.

Necessarily the decision below is in direct conflict with the last above mentioned decisions.

In *F. H. E. Oil Co.* v. *Commissioner,* 147 F. (2d) 1002, on rehearing 149 F. (2d) 238, on second rehearing, 150 F. (2d) 857, the court considered the validity of the long established regulation whereby a taxpayer is given the option either to capitalize drilling costs or to charge them to expense. The taxpayer there had elected to charge such costs to expense in computing net income. The deductions were disallowed by Respondent on the ground that such costs were essentially capital expenditures, and that the

Revenue Acts did not permit such expenditures to be deducted as items of expense. Respondent's position was sustained. In its first opinion the entire Regulation was held void on the ground that the tax laws did not permit capital expenditures to be deducted in computing net income. In its second opinion, while adhering to its views, expressed in its first decision, the court limited its decision to the cases immediately before it which involved drilling costs where the taxpayer was either seeking to retain an interest in property, or to enlarge or extend an existing interest. The court, however, pointed out that what made the Regulation even worse was the fact that it gave to the taxpayer an optional right to charge such drilling costs to capital or income as he might see fit.

The decision below is necessarily in conflict with the decision in the *Oil* case.

The conflict between the decision below and the decision in *Central* creates an impossible situation. Taxpayers in the utility field are especially affected by the decision below. Practically all utility companies, including railroads, for their own accounting purposes capitalize taxes and interest paid with respect to new construction, and have uniformly done so for a great many years. Such items are treated as elements of cost. Under certain circumstances the inclusion of such items as part of cost is required by other administrative agencies which regulate utility accounting. For example, it appeared in *Southern Railway Co.*, 27 B. T. A. 673, referred to above, that taxes and interest during construction were required by the Interstate Commerce Commission to be included in cost. Nevertheless they were excluded by Respondent and the Board in determining the income tax liabilities of the taxpayer. The Board there, after referring to the decision in *Central* and other like cases, quoted from *Kansas City Southern Ry.*

Co. v. *Commissioner*, C. A. 8, 52 F. (2d) 372, as follows (pp. 683-4):

> "Systems of accounting for railroads under the control of the Commission cannot interfere with the Government's system of taxation. The Commission has no power to direct how the revenue laws of the United States shall be interpreted, or by its orders provide standards to govern the taxing authorities."

Ever since the decision in *Central* came down, and in reliance thereon, Respondent has disallowed all such items as elements of cost and has held that all such items are deductible from income when incurred in accordance with the provisions of section 234(a) of the Revenue Act of 1926 and similar provisions of subsequent Revenue Acts and the Internal Revenue Code.

"Cost" is a controlling factor not only in determining depreciation and the like, but also in determining gain or loss in the event of the sale of the property, and particularly in determining abandonment losses. It is highly essential, both from the standpoint of the taxpayer as well as from the standpoint of the public revenue, that "cost" be determined correctly and in accord with our tax laws. Because of the decisions below, both taxpayers and the Government are confronted with two diametrically opposed decisions. Both cannot be right, and both cannot be given effect. The question is bound to come before others of the Federal courts, and, having to choose between the court below and *Central*, no matter what their choice may be, their decisions will only add to the conflict and confusion. Taxpayers in the utility field will undoubtedly want the decision below to stand, while at the same time the Government will be put to the necessity of making some fine drawn and unsubstantial distinctions if the effect of the decision below is to be avoided. In the nature of things, endless litigation is bound to ensue unless the present con-

flict is speedily and finally resolved by this Court. This Court, alone, can settle the question once and for all.

2. The decision below is in direct conflict with the great body of law applicable not only to the Revenue Acts prior to that of 1932, but to that Act and all of the later Acts up to the time of the 1942 amendments to the Code, to the effect, without exception, that interest on *new construction* is not a carrying charge, is not a capital item, and cannot be charged to capital account. Prior to the 1942 amendments, interest on new construction could no more be charged to capital account as constituting a carrying charge, or otherwise, under the special wording of the 1932 and subsequent Revenue Act, than it could be so charged under the purported authority of the 1924, 1926, and 1928 Regulations—assuming those Regulations to be valid. To the point that interest on new construction is not a carrying charge, and is not properly chargeable to capital account, we refer the Court to:

Columbia Theatre Co., 3 B. T. A. 622.
Spring Valley Water Co., 5 B. T. A. 660.
Eastern Rolling Mill Co., 5 B. T. A. 663.
Ottawa Park Realty Co., 5 B. T. A. 474.
Oswego and S. R. R. Co., C. C. A. 2, 29 F. (2d) 487, affirming 9 B. T. A. 904.
Moran v. *United States*, Ct. Cl., 19 F. Supp. 557.
Kentucky Natural Gas Corp. v. *Commissioner*, 47 B. T. A. 330.
Queensboro Corp. v. *Commissioner*, C. A. 2, 134 F. (2d) 942.

Other than the decisions herein, there are no decisions contrary to the holding of the above cases.

The decision below in this respect is extraordinary in its complete disregard of the heretofore established law. The court below not only cites no authority in support of its

view (there isn't any such authority, of course), but does not attempt even to discuss the question. Nor are the cases above cited even mentioned by the court below in its decision herein. The decision is even more extraordinary, and Respondent's position with respect to the interest item is even less understandable in view of the fact that he has explicitly stated by formal Regulation that interest on new construction was not properly chargeable to capital account prior to the 1942 amendments. (Reg. 103, Sec. 19.24-5, as added by T. D. 5251, March 27, 1943.) Cf. *Warner Mountains Lumber Co.*, 9 T. C. 1171, commencing at the bottom of page 1177, where the question of capitalizing interest was discussed at some length.

3. Apart from the interest question and the conflict between the decision below and the decisions cited above, it is of importance in the administration of our tax laws that this Court decide whether or not items of the kind here involved including especially interest on new construction, are or are not carrying charges. This is a further reason for granting certiorari herein. The question is of importance not only with respect to the Revenue Acts of 1924, 1926, and 1928 and the Regulations thereunder, but also with respect to the special wording of the 1932 and later Revenue Acts. The question is of large importance even under the 1942 amendments to the Code, which in Section 24(a)(7) authorized Respondent to provide by Regulation for the charging to capital account of "taxes and carrying charges." The court below has fallen into grave error in holding that the items here involved are carrying charges. From the standpoint of the public revenue, the Court's decision is fraught with extreme danger.

None of the Revenue Acts and none of the Regulations has ever purported to define the term "carrying charges."

Cf. *Warner Mountains Lumber Co.*, 9 T. C. 1171, at p. 1176. Nor has any court attempted such definition. In his brief in *Warner* (9 T. C. 1171) Respondent said:

> "Under the Revenue Act of 1932 taxes and other carrying charges on unimproved and unproductive property can be added to cost basis conditioned on the item being 'properly chargeable to capital account.' The query is then raised as to what items are 'properly chargeable to capital account.' The field here is very limited. It has always been held that such items are those which add to the value of the original investment. *The Queensboro Corporation, supra.* Taxes on unproductive property have been specifically added as an item which can always be chargeable to capital account. Section 113(b)(1)(A). It has also been held that interest paid on the purchase price of unproductive property can now be charged to capital account. Other than these two items the field of 'carrying charges properly chargeable to capital account' is very narrow, and it is difficult, if not impossible, to enumerate any other classes of 'carrying charges properly chargeable to capital account.' See *The Queensboro Corporation, supra.*"

The Tax Court in its decision herein, simply assumed that the items were carrying charges. (R. 57.) The court below, in its opinion, dismissed the question with the following statement (R. 94):

> "The petitioners also contend that the charges in question are not actually carrying charges within the meaning of capital expenditures. Under the facts in this case it will be sufficient to say that all the charges involved were incurred while the property was unproductive, and undoubtedly were assumed for the purpose of converting it into the productive state for which it was acquired."

We have found no decision on the point as to whether rent is a carrying charge, or whether there is a distinction

between rent paid under an ordinary short term lease and rent paid under a long term lease, as in the instant case, which involve a 99-year lease. Respondent relies on G. C. M. 11197, C. B. XII-1, 238, as his sole authority for contending that rent is a carrying charge. The only possible reason for saying that rent is a carrying charge is that the property itself is unproductive. But where the property is unproductive there would be no gross revenue from which the rent would be deducted, and hence whether rent is or is not deducted as an expense would not affect "net income." Obviously in such a case the public revenue is not harmed. Either the deduction or non-deduction of the rent would of itself be immaterial. But if rent is included as an element of cost the public revenue would be very much effected thereby. Depreciation allowances would be increased. The gain, if any, resulting from a subsequent sale of the property would be decreased, or the loss, if any, would be increased. And if the property were abandoned the loss, deductible in full, would likewise be enhanced. By adding rent, paid with respect to unproductive property, to cost, the taxpayer, through his depreciation allowance, would secure the full benefit of a rent deduction just as if it had been deducted in computing net income and the gross income were sufficient to absorb it.

Even in the present Regulations (Reg. 111, Sec. 29.24-5), adopted under the express authority of Section 24(a)(7) above, rent is not included as being a "carrying charge" which can be capitalized.

Taxes on unproductive property, when paid by the owner, are regarded as carrying charges. But, for income tax purposes, real estate taxes paid by a lessee for the lessor's account under the requirements of the lease are regarded not as taxes but as so much additional rent. (Art. 110, Reg. 65 (1924); Art. 111, Reg. 69 (1926); Art. 130, Reg. 74

(1928); Reg. 103, Sec. 19.23(a)-10; Reg. 111, Sec. 29.23(a)-10.) Taxes so paid would seem to be in the same category as the rent itself, and if rent is not a carrying charge, then taxes so paid by the lessee are likewise not carrying charges. As to the other taxes, the Michigan state tax on bonds ($155) and the Illinois franchise tax ($500) are clearly "taxes" required to be deducted under the express wording of Section 234(a) of the 1926 Act in computing net income. As to the Federal income tax paid by the corporation with respect to its tax free covenant bonds ($5,227.50), granting that such tax is not deductible in computing net income by virtue of the express provisions of Section 234(a)(3)(A), nevertheless the tax is still a tax and can in no event be said to be a "carrying charge" so far as the property itself is concerned. The result is that none of the taxes, including the real estate taxes, can be held to be carrying charges.

The financing charges, amounting to $33,285.42 (R. 33), would seem to be an ordinary expense of the business, deductible as such in computing net income. No more than the other items are the financing charges to be regarded as "carrying charges." Cf. *Moran* v. *United States,* Ct. Cls., 19 F. Supp. 557.

Conclusion.

Determination of "cost" is an ever present problem. "Cost" controls the amount of depreciation and the like which may be deducted in computing net income. "Cost" controls the determination of gain or loss upon a subsequent sale or exchange of the property, and controls the amount of loss which may be deducted upon abandonment. The determination of the elements constituting cost should therefore not be left in its present chaotic condition, which is the result of the decision below. While it is true that the question in the instant cases comes up in connection

with the determination of the "earnings or profits" of the corporation and therefore it is to Respondent's advantage to contend that the items here involved are carrying charges and were properly charged to capital account in 1926 and 1927 to the end that the accumulated earnings of the company as per the books should remain unchanged, and to the end that Petitioners be taxed upon the 1941 distribution as a dividend, nevertheless the necessity of a correct determination of "cost" is of much greater importance, certainly from the standpoint of the Treasury itself.

As late as his brief in the *Warner Mountains Lumber* case, heretofore referred to, Respondent was earnestly contending that the *Central Real Estate Co.* decision was correct, and that carrying charges could not be capitalized under any of the Revenue Acts prior to that of 1932. It is not readily apparent why Respondent at this late date, and so suddenly, has so radically changed his position in regard to the *Central* decision. Certainly the collection of the comparatively small amount of taxes from these Petitioners would not seem adequate ground for the change. It is no answer to say, as the court below said, that it had "no concern with alleged errors which he [Respondent] may have alleged to other courts." (R. 94-5.) The court is concerned, however, or should be concerned, with correctly deciding the issue before it. And, after all, Respondent's long acquiescence in the *Central Real Estate* decision, his persistent reliance thereon in determining the income tax liabilities of innumerable taxpayers, his repeated and unequivocal statements in other cases, and to other courts, that the decision in *Central* was correct, the lapse of more than seventeen years since *Central* was decided, its acceptance by taxpayers and by the courts generally, together with the obvious soundness of the decision itself, should have induced the court below to give pause before it overturned the *Central* decision.

Petitioners respectfully urge that the writs herein prayed be granted, to the end that the existing confusion be cleared up, and the conflict in decisions resolved.

Respectfully submitted,

CARROLL J. LORD,
Attorney for Ernest A. Jackson, One of the Above Named Petitioners.

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Attorneys for Harris Trust and Savings Bank, as Executor (Estate of Robert O. Farrell, Deceased), One of the Above Named Petitioners.

APPENDIX.

Revenue Act of 1924.

Sec. 202. * * *

(b) In computing the amount of gain or loss under subdivision (a) proper adjustment shall be made for (1) any expenditure properly chargeable to capital account. * * *

Revenue Act of 1926.

Sec. 202. * * *

(b) In computing the amount of gain or loss under subdivision (a)—

(1) Proper adjustment shall be made for any expenditure or item of loss properly chargeable to capital account. * * *

Sec. 234. (a) In computing the net income of a corporation * * * there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * * and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness. * * *

(3) Taxes paid or accrued within the taxable year except (A) income, war-profits, and excess-profits taxes imposed by the authority of the United States. * * *. In the case of obligors specified in subdivision (b) of section 221 no deduction for the payment of the tax imposed by this title, or any other tax paid pursuant to the tax-free covenant clause, shall be allowed, nor shall such tax be included in the gross income of the obligee. * * *

Revenue Act of 1928.

Sec. 111. *Determination of Amount of Gain or Loss.* • • •

(b) ADJUSTMENT OF BASIS—In computing the amount of gain or loss under subsection (a)—

(1) Proper adjustment shall be made for any expenditure, receipt, loss, or other item properly chargeable to capital account. • • •

Revenue Act of 1932.

Sec. 113. *Adjusted Basis for Determining Gain or Loss.* • • •

(b) ADJUSTED BASIS—• • •

(1) GENERAL RULE—Proper adjustment in respect of property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items properly chargeable to capital account including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable or prior taxable years; • • •

Article 1561, Regulations 65 (1924).

• • • • • •

• • • In computing the amount of gain or loss, however, the cost or other basis of the property, must be increased by the cost of capital improvements and betterments made to the property since the basic date, and by carrying charges, such as taxes on unproductive property, • • •.

Article 1561, Regulations 69 (1926).

• • • • • •

• • • In computing the amount of gain or loss, however, the cost or other basis of property must be increased by the cost of capital improvements and betterments made to the property since the basic date, and by carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or

use such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property. * * *

Article 561, Regulations 74 (1928).

* * * * *

* * * In computing the amount of gain or loss, however, the cost or other basis of the property shall be properly adjusted for any expenditure, receipt, loss, or other item properly chargeable to capital account, including the cost of improvements and betterments made to the property since the basic date and carrying charges, such as taxes on unproductive property. Where the taxpayer has elected to deduct carrying charges in computing net income, or use such charges in determining his liability for filing returns of income for prior years, the cost or other basis may not be increased by such items in computing the gain or loss from the subsequent sale of the property.

Article 605, Regulation 77 (1932).

* * * * *

The cost or other basis shall be properly adjusted for any expenditure, receipt, loss, or other items, properly chargeable to capital account, including the cost of improvements and betterments made to the property. * * * In the case of unimproved and unproductive real property, carrying charges, such as taxes and interest, which have not been taken as deductions by the taxpayer in determining net income for the taxable year, or a prior taxable year, are properly chargeable to capital account.